

NCUA LETTER TO CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION
1775 Duke Street, Alexandria, VA 22314

DATE: November 2013 **LETTER NO.:** 13-CU-13

TO: Federally Insured Credit Unions

SUBJ: Changes to NCUA Regulations Related to Credit Union
Service Organizations

ENCL: 1) Appendix A: CUSO Reporting Requirements
2) 12 CFR Parts 712 and 741, Final Rule

Dear Board of Directors and Chief Executive Officer:

On November 21, 2013, the NCUA Board adopted changes to the regulations that address federally insured credit unions' responsibilities when involved with a credit union service organization (CUSO).

This letter outlines the primary changes to the CUSO-related rules, as well as what your credit union needs to do as a result of the changes. **These regulatory changes will become effective June 30, 2014.**

Why did NCUA change the CUSO-related rules?

NCUA recognizes that CUSOs provide significant value to the credit union industry by allowing organizations to collaboratively share risk, manage costs, and deliver services to credit union members. The unique collaborative business model of CUSOs fosters cooperation and shared innovation for credit unions, allowing them to achieve economies of scale, retain expertise, and better serve their members.

However, CUSOs also pose potentially widespread financial and operational risks to credit unions and the National Credit Union Share Insurance Fund. Since 2008, CUSOs have caused credit unions more than \$300 million in direct losses and led to failures of credit unions with combined assets of more than \$2 billion.

Without these changes to the CUSO regulations, NCUA cannot fully determine the financial condition of CUSOs, the full range of services offered by each CUSO, an accurate number of CUSOs in operation, or the relationship between a specific CUSO

and a specific credit union.¹ This lack of accurate information limits the agency's ability to conduct offsite monitoring, assess emergent risks, and manage losses to the Share Insurance Fund. To address these potential risks, the Board has changed the CUSO-related rules to extend certain requirements to all federally insured credit unions and improve the quality of information about credit unions' use of CUSOs.

The final regulations strike a reasonable balance by collecting basic information on all CUSOs and limiting the requirement to provide more extensive information to those CUSOs that provide services that involve higher risk to credit unions. In the future, CUSOs will provide reports directly to NCUA, reducing the current regulatory burden credit unions have in reporting certain CUSO data to the agency.²

What are the primary changes to the CUSO-related rules?

The following table summarizes the primary changes to the rule, indicates which credit unions are affected, and outlines what action credit unions need to take in order to comply with the regulations.³ More detailed information on each of the changes appears on the following pages.

Table: Summary of Primary Changes to CUSO-Related Rules

	Rule Element	Credit Union Action (Required by June 30, 2014)
New for all Credit Unions	<i>CUSO Subsidiaries</i> – clarifies applicability of the regulations to CUSO subsidiaries.	None
	<i>CUSO Registry</i> – requires credit unions to ensure that the CUSOs with which they do business agree to provide certain information directly to NCUA and the state supervisory authority, as applicable, on an annual basis.	Amend written agreement between credit union and CUSO
New for all Federally Insured, State-Chartered Credit Unions*	<i>CUSO Accounting</i> – requires credit unions to ensure that the CUSOs with which they do business agree to comply with generally accepted accounting principles and obtain a financial statement audit.	Amend written agreement between credit union and CUSO
	<i>Less than Adequately Capitalized Federally Insured, State-Chartered Credit Unions</i> – added preapproval process for federally insured, state-chartered credit unions that are, or would be rendered, less than adequately capitalized by an additional investment in a CUSO.	None

* These provisions previously only applied to federal credit unions.

¹ Current information is incomplete primarily because NCUA collects information from credit union clients rather than directly from each CUSO. According to NCUA records, of the 4,189 federal credit unions that filed a 5300 call report as of June 30, 2013, more than one third (1,413) reported at least one interest in a CUSO; a total of 3,275 CUSO interests were reported. Further, of the 2,492 federally insured state-chartered credit unions that filed a 5300 call report as of June 30, 2013, 46.6 percent (1,161) reported an interest in at least one CUSO; a total of 2,836 CUSO interests were reported.

² Credit unions currently report certain CUSO data in the CU Online profile and in response to 5300 call reports.

³ The final regulations also include some technical and administrative revisions to the rule text.

CUSO Subsidiaries

The new CUSO regulations apply to all levels, or tiers, of a CUSO's structure. Any subsidiary in which a CUSO has an *ownership interest of any amount* is treated as a CUSO, and is subject to the regulations *if it is engaged primarily in providing products or services to credit unions or credit union members*.⁴

There is an inherent risk that a subsidiary CUSO could adversely affect the investing credit union and, ultimately, the NCUSIF. This provision was explicitly included in the regulation to ensure that credit unions and CUSOs are aware that the requirements of the NCUA regulations, and applicable state rules, apply to all subsidiary entities in which a CUSO invests. This includes entities with the appearance of being formed to evade the CUSO-related rules.

CUSO Registry

Before investing in or lending to a CUSO, your credit union must obtain a written agreement from the CUSO indicating that it will provide information to NCUA and the state supervisory authority, as applicable, on an annual basis.⁵

CUSOs will submit this information directly to NCUA via an online registration system by **December 31, 2015**, as soon as the agency's reporting system is fully operational. [Appendix A](#) outlines the new reporting requirements planned for CUSOs.

CUSO Accounting

Before investing in or lending to a CUSO, your credit union must obtain a written agreement from the CUSO indicating that it will:⁶

- Account for all transactions in accordance with generally accepted accounting principles;
- Prepare quarterly financial statements; and
- Obtain an annual financial statement audit of financial statements by a licensed certified public accountant in accordance with generally accepted auditing standards.⁷

⁴ The provision will not apply to third parties with whom a CUSO contracts or otherwise does business where they do not have an ownership interest.

⁵ See NCUA Rules & Regulations - Section 712.3(d)(4)

⁶ See NCUA Rules & Regulations - Section 712.3(d)(1) and Section 712.3(d)(2)

⁷ A separate audit is not required for a wholly owned CUSO if it is included in the consolidated audit of the investing credit union.

Less than Adequately Capitalized Federally Insured, State-Chartered Credit Unions⁸

The regulations establish a limit on additional investments in a CUSO by a federally insured, state-chartered credit union that is, or would be rendered, less than adequately capitalized. A federally insured, state-chartered credit union in this situation must obtain prior written approval from its state supervisory authority and notify the NCUA regional director if its aggregate cash outlay exceeds the investment limit in the state in which the credit union is chartered. If there is no limit in the state in which the credit union is chartered, then the credit union's aggregate cash outlay is limited to one percent of paid-in and unimpaired capital and surplus.

Conclusion

If you have or plan to make a loan to or investment in a CUSO, you need to familiarize yourself with the requirements of the final regulations. Please contact your regional office or state supervisory authority if you have questions regarding this letter.

Sincerely,

/s/

Debbie Matz
Chairman

Enclosures

⁸ See NCUA Rules & Regulations - Section 712.2(d)(3). Conditions for recapitalization of CUSOs previously applied only to federal credit unions (FCUs).